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Background

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U.S. BUSINESS OUTLOOK LONG-TERM

Executive Summary

After three years of stagnation, the U.S. economy finally managed to mount a recovery in 1983.

At a minimum it looks like that recovery should make it through the rest of the year. Problem is that huge federal budget deficits threaten to keep interest rates high; and if the recovery leads to a spurt in private credit demands, a spike in interest rates could derail the recovery in 1984.

McGraw-Hill's long-term forecast does not call for such dire consequences next year. But the forecast does assume that persistent pressure on financial markets from record deficits will keep interest rates higher than normal for many years. Hence economic growth in the next decade is forecast at only 2.8% per year on average, compared to better than 3% in every decade since World War II.

On the brighter side, given today's huge amount of idle human and industrial capacity, inflation is not expected to be a near-term threat to the economy. Moreover, in this era of disinflation, companies are expected to concentrate capital spending on cost-cutting equipment. With costs under better control in the 1980s than in the 1970s, profits can grow without resort to major price increases.

Part of the improved inflation outlook will be due to only moderate petroleum price increases. Barring a Mideast political crisis, oil prices should remain fairly well behaved because of

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significant conservation and fuel switching efforts by U.S. business and households.

The forecast's major assumptions are shown in the chart below.

Assumptions	Impact on Growth in 1980s vs. the 1970s
Oil prices rise modestly faster than prices in general	positive
Inflation remains modest, 6%-7%	positive
Interest rates stay high	negative
Labor force growth slows	negative
Research & development is robust	positive
Capital investment lifts productivity	positive
Technology advances at historical rate	no change
Exports hurt by strong dollar	negative

If these assumptions prove invalid, the economy would not grow as forecast. If, for example, a Mideast crisis doubles oil prices, then inflation would surge, forcing up interest rates, depressing capital investment and productivity. Or if the federal deficit grows even more obese, interest rates could move to the 20% range. Thus a low-ball forecast calls for long-term economic growth of only 2%.

By contrast, the federal government could conceivably put its fiscal house in order, leading to lower interest rates, a robust housing recovery, higher capital spending and productivity growth. In that case, it's possible for the economy to grow 3.4% a year on average.